United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

Original

74-2001

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

B
p/s

L. JOHN JACOBI and ROBERT GAMBERA, individually, on behalf of the members of the AMERICAN ASSOCIATION OF SECURITIES REPRESENTATIVES, and on behalf of all other securities representatives similarly situated,

Plaintiffs-Appellants,

—against—

BACHE & CO., INC.; WALSTON & CO., INC.; THOMSON & McKINNON AUCHINCLOSS, INC. (formerly THOMSON & McKINNON, INC.); HORNBLOWER & WEEKS-HEMPHILL, NOYES; LOEB, RHOADES & COMPANY; TUCKER, ANTHONY & R. L. DAY; HARRIS, UPHAM & CO., INC.; DOMINICK INT'L CORP.; HALLE & STIEGLITZ, INC.; GOODBODY & CO.; BEAR, STEARNS & CO.; LEHMAN BROS.; KIDDER, PEABODY & CO., INC.; R. W. PRESSPRICH & CO., INC.; DEAN WITTER & CO., INC.; W. E. HUTTON; REYNOLDS & CO.; PAINE, WEBBER, JACKSON & CURTIS; SCHEINMAN, HOCKSTIN & TROTTA, INC.; PRESSMAN FROLICH & FROST, INC.; NEWBURGER, LOEB & CO.; RAUSCHER, PIERCE SECURITIES CORP.; OPPENHEIMER & CO.; STEINER ROUSE & CO., INC.; L. F. ROTHSCHILD & CO.; SPENCER TRASK & CO.; SMITH, BARNEY & CO., INC.; and THE NEW YORK STOCK EXCHANGE, INC.,

Defendants-Appellees.

Appeal From the United States District Court
For The Southern District of New York

BRIEF FOR APPELLEES

The Names of Counsel
Appear at the End of
the Brief

2

October 30, 1974

TABLE OF CONTENTS

TABLE OF CASES AND AUTHORITIES

PAGE

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For the Second Circuit

74-2001

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Issue Presented for Review

The sole issue presented for review is whether the District Court (Ward, J.) correctly dismissed this action—which challenged, as an antitrust violation, a rule of the New York Stock Exchange, Inc. (the "Exchange")—in light of the District Court's findings, after a full trial, that the rule challenged was adopted pursuant to the authorization of Section 19(b) of the Securities Exchange Act of 1934 (the "Exchange Act"; 15 U.S.C. § 78a, § 78s(b)), was subjected to the review of the Securities and Exchange Commission (the "SEC"), and was both reasonable under the antitrust laws and justified because in furtherance of the purposes of the Exchange Act.

Counter-Statement of Facts

Plaintiffs' recitation of the facts (Plaintiffs' Brief ["Pl. Br."] pp. 3-17), while lengthy and burdened with material non-essential to the disposition of this appeal, is nonetheless incomplete. Plaintiffs give scant attention to the few and undisputed facts which were found by the District Court to mandate dismissal of this action.

The heart of this case—and the basis upon which defendants claim an antitrust exemption as well as request affirmance of the District Court's conclusion that the self-regulatory conduct here challenged was reasonable and justified—may be briefly summarized as follows:

During late 1969 and early 1970, the member firms of the Exchange were experiencing a serious financial crisis and operating at increasing losses, particularly in low volume securities transactions. The minimum commission rate had last been increased in 1958, while costs to the industry in the succeeding decade had risen by some 60%. (412A-413A)

The Exchange retained National Economic Research Associates, Inc. ("NERA") to conduct studies and to assist in the development of a new commission rate structure. In February, 1970, the Exchange presented NERA's analysis together with its own recommendation for a new rate structure to the SEC. (413A)

The SEC's response indicated certain unresolved issues and the need for additional data before approval of the new rates; it appeared that approval of a comprehensive new rate structure would require some time. In the meantime, the increasingly acute financial difficulties of some member firms threatened their continued operation. (Id.)

Therefore, acting pursuant to its Exchange Act obligation to protect investors from the danger of a financially

insecure brokerage community (see Sections 6(d) and 19(b)(1)), the Exchange formulated Rule 383 (imposing the interim service charge) in order to insure the financial stability of its member firms. (248A-253A) The Exchange then formally submitted the rule to the SEC for approval in accordance with SEC Rule 17a-8 (17 C.F.R. § 240.17a-8), specifically noting in its submission that Rule 383 would be adopted pursuant to Article XV, Section 9 of the Exchange's Constitution, which expressly prohibits the sharing of service charges by member firms with their employees. (251A-253A) However, the Exchange also advised the SEC as well as its member firms that compensation policies remained matters for the individual discretion of the member firms, subject only to the stated service charge restriction and the requirement that any salary increase not imperil the member firm's financial integrity. (See 414A)

Article XV, Section 9 was at that time (and had been for many years) on file with the SEC as is required by § 6(a)(3) of the Exchange Act (15 U.S.C. § 78f(a)(3)). Both prior to, and immediately following, the Exchange's formal submission of Rule 383, extensive discussions took place between Exchange officers and SEC officials concerning both the necessity for and the impact of the rule. (259A-261A; 265A-274A) The SEC, in discharge of its Section 19(b)(1) obligation to safeguard the financial responsibility of brokerage firms doing business on registered exchanges (15 U.S.C. § 78s(b)(1)) and in exercise of its Section 19(b)(9) authority to protect investors by insuring the fixing of reasonable rates of commission and other charges (15 U.S.C. § 78s(b)(9)), carefully scrutinized the rule. (259A-261A)

Conditions for the rule's approval were imposed. In its letter, sent pursuant to SEC Rule 17a-8, which set forth the SEC's non-objection to Rule 383, the SEC expressly required that the Exchange take steps to assure that all

brokerage services were restored to small investors. It also required that the Exchange insure that revenues derived as the result of Rule 383 were prudently employed by member firms "to improve their operations and financial position." In addition, the SEC specifically predicated its non-objection to the rule upon the Exchange's pledge to provide continuing financial data on the operation of the service charge so that its effects could be carefully monitored. These data, of course, reflected that interim service charge revenues were not being used to raise the amount of registered representatives' compensation. (259A-261A; 414A)

Thereafter, the SEC maintained close surveillance over the administration of the service charge. (262A-264A) That the SEC was aware that the Exchange prohibited member firms from paying commission compensation to their registered representatives based on the service charges is beyond doubt. (416A) In addition to the fact that Article XV, Section 9 was on file with the SEC, the SEC received a telegram on May 19, 1970 from the Association of Investment Brokers requesting it to intervene and direct the Exchange to lift its restriction. (322A) This the SEC declined to do, though noting that it would be receptive to evidence demonstrating that an exercise of Section 19(b) authority over this matter was "necessary or appropriate". (322A) Furthermore, hearings on the service charge were held by the SEC in July 1970, during which registered representatives again complained of the effects of Article XV, Section 9. (416A; 323A-326A) The SEC once more refused either to request or direct the Exchange to alter the rule. Instead, it affirmatively permitted the service charge to continue in effect until March of 1972.

At no time during the existence of the service charge did the Exchange include service charge revenues in the basis upon which it calculated its own charge to member firms for transactions executed on the Exchange, amount-

ing at the time to 1% of the commissions each firm collected. (414A)

Summary of Argument

The District Court correctly dismissed plaintiffs' action, holding that Article XV, Sections 1 and 9 of the Exchange's Constitution and Rule 347(a) of the Exchange's Rules—as they affected member firm use of the relief revenues generated by the service charge—did not violate the antitrust laws. In retrospect, however, it is apparent that the District Court's reasoning went further than necessary in ruling that the challenged conduct was even susceptible to antitrust attack. This error was primarily the product of unfortunate timing.

The District Court decided this case nearly one month prior to—and, thus, was without the guidance of—this Court's decision in *Gordon* v. *New York Stock Exchange*, 498 F.2d 1303 (2d Cir. June 28, 1974), *aff'g,* 366 F.Supp. 1261 (S.D.N.Y. 1973)*, which defined the scope of an exchange's antitrust exemption for self-regulation subject to SEC supervisory jurisdiction.

In *Gordon,* this Court squarely held that exchange rules—such as those fixing minimum rates of commission—are exempt from antitrust attack when adopted by an exchange pursuant to its mandated powers of self-regulation, generally defined by Section 19(b) of the Exchange Act, and subject to SEC oversight jurisdiction. (498 F.2d at 1305)

Since, as the District Court found as a matter of fact, the Exchange rules challenged here were adopted in the legitimate exercise of 19(b) self-regulation and actually reviewed by the SEC (423A; 435A-436A), this case is controlled by

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* A petition for a writ of certiorari was filed in *Gordon* on September 19, 1974, 43 U.S.L.W. 3148.

Gordon. This Court can and should affirm the District Court's dismissal of the action on the authority of that case.

Notwithstanding the fact that *Gordon* compels affirmance of the decision below on the ground of antitrust exemption, defendants submit that, once having failed to find an exemption, the District Court's decision, premised on the rule of reason, was correct in finding the challenged conduct justified under the antitrust laws and in furtherance of the purposes of the Exchange Act.

Thus, to put both these issues before this Court, and to respond directly to plaintiffs' argument, defendants have chosen to deal first with the District Court's application of the rule of reason and, then, in turn, to deal with the exemption issue.

ARGUMENT

I

The District Court Properly Applied a Rule of Reason Analysis and Correctly Found no Violation of the Antitrust Laws.

A. Since Plaintiffs Limited Their Case to a *Per Se* Attack on Exchange Self-Regulatory Conduct, Dismissal was Proper Under the *Silver* Doctrine.

Plaintiffs concede (Pl.Br. pp. 2, 4-5, 20, 28) that their claims were limited strictly to a *per se* attack on the Exchange's interim service charge rules as they affected registered representative compensation during the period April 2, 1970 to June 25, 1971. Plaintiffs argued below (426A-427A), and argue now (Pl.Br. pp. 22-26, 28), that absent an antitrust exemption *all* exchange self-regulation is *per se* violative of the antitrust laws because necessarily the product of horizontal agreements among competitors. This extravagant proposition is both wrong as a matter of gen-

eral antitrust law,* and, more important, is in flat contradiction to the authorities governing reconciliation of the antitrust laws with the Exchange Act.

In support of their erroneous *per se* argument, plaintiffs advance a host of inapposite cases (Pl.Br. Point I) concerning practices in unregulated sectors of the economy. Plaintiffs completely ignore the only cases which deal directly with this issue in the context of an antitrust challenge to practices regulated by the SEC under the Exchange Act —*Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); *Thill Securities Corp.* v. *New York Stock Exchange*, 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971);** *Gordon* v. *New York Stock Exchange*, *supra; Robert W.*

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* Plaintiffs are simply mistaken in their contention (Pl.Br. p. 23) that all horizontal agreements among competitors are *per se* violations of the antitrust laws. As the District Court pointed out (430A-431A), there are many antitrust precedents which have validated horizontal agreements. Plaintiffs seek to denigrate this authority by labeling (Pl.Br. p. 23) it of "ancient vintage" and of "little current value". No better examples of the weakness of plaintiffs' position are necessary than the continued vitality of Associated Press v. United States, 326 U.S. 1 (1945) (cooperative venture among 1200 newspapers comprising some 60% of the English language papers in the United States) and, United States v. Morgan, 118 F.Supp. 621 (S.D.N.Y. 1953) (Medina, J.) (validation, under the rule of reason, of the syndicate device for the underwriting of public issues).

Likewise, plaintiffs' contention (Pl.Br. pp. 24-25) that any horizontal arrangement which has any effect on price is a *per se* violation is equally faulty. Every restraint has some effect on price since that is the primary mode of competition in a market economy. As the District Court suggested (431A-433A), labeling a practice as price fixing is not part of an antitrust analysis but rather the resulting legal conclusion. Many cases have upheld trade arrangements with an admitted effect on price. *E.q.*, Standard Oil Co. (Indiana) v. United States, 283 U.S. 163 (1931).

** This Court in Gordon v. New York Stock Exchange, *supra*, while expressly disagreeing with *Thill* insofar as its reasoning failed to support a finding of antitrust exemption for exchange rules subject to SEC review, left undisturbed the balance of *Thill's* reasoning which here demonstrates that *per se* rules are inapplicable to exchange self-regulatory conduct.

Stark, Jr., Inc. v. *New York Stock Exchange,* 346 F.Supp. 217 (S.D.N.Y.), *aff'd per curiam,* 406 F.2d 743 (2d Cir. 1972) and, *United States* v. *Morgan,* 118 F.Supp. 621 (S.D.N.Y. 1953) (Medina, J.); see *Cowen* v. *New York Stock Exchange,* 371 F.2d 661, 664 (2d Cir. 1967); see also *Kaplan* v. *Lehman Bros.,* 250 F.Supp. 562 (N.D.Ill. 1966), *aff'd,* 371 F.2d 409 (7th Cir.), *cert. denied,* 389 U.S. 954 (1967) and, *Fredrickson* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 5 CCH Trade Reg. Rep. 1974-2 Trade Cas. ¶75,227 (N.D.Ill. Sept. 9, 1974).

A decade before *Silver,* Judge Medina in *United States* v. *Morgan* recognized the impropriety of applying *per se* concepts to conduct not otherwise immune from the antitrust laws but undertaken subject to the SEC's Congressionally-established oversight jurisdiction. (118 F.Supp. at 689 and 694)

More pointedly, *Silver*—the controlling authority here—makes clear that plaintiffs' argument that a *per se* rule of illegality must be applied is entirely without merit. In *Silver,* it was argued that, in the absence of antitrust immunity, the application of the antitrust laws would stifle Exchange self-regulatory action. The Supreme Court responded:

> "*. . . under the aegis of the rule of reason,* traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act. . . . Although, as we have seen, the statutory scheme of that Act is not sufficiently pervasive to create a total exemption from the antitrust laws . . ., it is also true that particular instances of exchange regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." (373 U.S. at 360-361) (Emphasis added)

The Supreme Court devoted an entire section of the *Silver* opinion to the question of justification, which would clearly have been superfluous if a *per se* doctrine were applicable. (373 U.S. at 361-367)

The Supreme Court's reliance in *Silver* on two classic rule of reason cases, *United States* v. *Terminal R. Assn. of St. Louis,* 224 U.S. 383 (1912) and *Board of Trade of the City of Chicago* v. *United States,* 246 U.S. 231 (1918), emphasizes the applicability of the rule of reason and further indicates the kind of factual inquiries which the Supreme Court had in mind for the judicial review of exchange self-regulatory power:

> "Whether it is a facility [unification of terminal facilities] in aid of interstate commerce or an unreasonable restraint forbidden by the act of Congress, as construed and applied by this court in the cases of *The Standard Oil Company* v. *The United States,* 221 U.S. 1, and the *United States* v. *American Tobacco Company,* 221 U.S. 106, will depend upon the intent to be inferred from the extent of the control thereby secured over instrumentalities which such commerce is under compulsion to use, the method by which such control has been brought about and the manner in which that control has been exerted." *United States* v. *St. Louis Terminal R. Assn.,* 224 U.S. at 394-5. (quoted at 373 U.S. at 360)

> ". . . the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition

before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences." *Chicago Board of Trade* v. *United States,* 246 U.S. at 238. (quoted at 373 U.S. at 360)

The Court of Appeals for the Seventh Circuit in *Thill, supra,* was most explicit on this issue:

> ". . . the rationale of *Silver* . . . made 'plain that action taken by the Exchange and its members, pursuant to its statutory authority to make rules, is not illegal *per se* under the Sherman Act.' " 433 F.2d at 270,

and remanded to the District Court with instructions to assess "the effects of the anti-competitive conduct complained of. . . ." (433 F.2d at 270)

Likewise, Judge Brieant found in *Stark, supra* (in an opinion affirmed by this Court) that

> "The most that can be said for plaintiff's position on the anti-trust laws is that a triable issue of fact exists as to whether the totality of restraints on competition imposed by NYSE, inherent in any system for conduct of a national securities exchange, are reasonable in degree. . . ." (346 F.Supp. at 230)

Most recently, in this Court's *Gordon* decision, reference is made to what the Supreme Court termed in *Silver* the "breathing space" afforded by the rule of reason to non-exempt exchange self-regulation. (498 F.2d at 1305)

In short, it was no error for the District Court to reject plaintiffs' demand for the application of a *per se* rule. Such a rule simply has no place when considering exchange self-regulatory conduct within the scope and purposes of the Exchange Act.

Moreover, plaintiffs' argument on this appeal makes clear that they misapprehend the significance of the applicability of a rule of reason test. Unlike a *per se* rule which operates as an irrebuttable presumption that a challenged practice—once proved—is both anticompetitive in purpose and effect and likewise unjustifiable, a plaintiff's *prima facie* burden under the rule of reason is not met until he proves not only the existence of a restraint but also its anticompetitive effect and the substance of the resulting injury arising from the diminution of competition complained of. By their own admission (see Pl.Br. p. 28), plaintiffs did neither.

In fact, plaintiffs offered no proof even that the rules which they claimed restrained trade were the direct or proximate cause of any member of the class receiving less compensation than he otherwise would have received in the absence of the alleged unlawful conduct.*

Plaintiffs simply proved no element of their *prima facie* case. Accordingly, the District Court quite properly could have dismissed this action without even considering the Exchange's justification for the interim service charge

* This failure of proof raised grave questions as to plaintiffs' standing to sue, under Section 4 of the Clayton Act (15 U.S.C. § 15), which the Court below did not fully consider. *See* Billy Baxter, Inc. v. Coca Cola Co., 431 F.2d 183 (2d Cir. 1970), *cert. denied*, 401 U.S. 923 (1971). Likewise, the Court below could have, but did not dismiss plaintiffs' action because they failed to adduce any proof on damages to the class as a whole or to the representative plaintiffs. *See, e.g.*, Keogh v. Chicago & Northwestern R.R. Co., 260 U.S. 156 (1922); McCaskill v. Texaco, Inc., 351 F.Supp. 1332 (S.D.Ala. 1972); Riss & Co. v. Assn. of Amer. R.R., 190 F.Supp. 10 (D.D.C. 1960). In this connection, plaintiffs' opening assertion (Pl.Br. p. 5) that the Court found they had proved damages is incorrect. The Court merely concluded that there was some showing of injury. (425A-426A)

restriction. Instead, the Court went further and, assaying all the facts presented by the parties, found the conduct challenged to be reasonable and justified.

B. The Court Below Correctly Held the Challenged Conduct Justified Under the Rule of Reason.

Plaintiffs take issue not only with the District Court's application of the rule of reason, but also with the findings of reasonableness which the Court made. Plaintiffs contend (see Pl.Br. p. 28) that the Court had no basis for its findings, since no evidence was before the Court on the justification and reasonableness of the interim service rules. This is a mischaracterization of the record; the only gap in the evidence was the one created by plaintiffs who, on the mistaken assumption that a *per se* rule applied, dispensed with proof of their case-in-chief.

For example, plaintiffs offered no evidence supporting the underlying premise of their case: that during the relevant period there existed an economically definable market among member firms of the Exchange for the services of registered representatives. Likewise, plaintiffs submitted no evidence that any such labor market for securities salesmen could properly exclude suitable alternative employment by member firms of other exchanges or other securities-related businesses and, thereby, legitimately be limited to the alleged Exchange member firm service market. Moreover, plaintiffs never explained how their proof, much less their suit, could be limited to some thirty member firms—four of whom were dismissed as parties—leaving as defendants only an apparently arbitrary 26 out of over 500 member firms. Even with such selectivity plaintiffs were unable to establish any uniformity in compensation levels or patterns. And, as the District Court noted, comparisons between differing sorts of compensation arrangements at the various member firms were extremely difficult. (see 417A)

Plaintiffs admit (Pl.Br. p. 28) that they introduced no evidence suggestive of the level and intensity of competi-

tion in their alleged, but unsubstantiated, market of 26 member firms. Similarly, plaintiffs offered no evidence as to the competitive effect of the restriction against sharing interim service charge revenue with registered representatives. The District Court found as a matter of fact that the individual firms' compensation policies were unaffected, and, thus, competition unabated. (414A)

In contrast to the blank page presented by plaintiffs, defendants provided ample evidence of the reasonableness and justification for the challenged restriction.

It was uncontested, and the District Court found that (1) the imposition of the interim service charge was a proper exercise of the authority granted the Exchange under Section 19(b)(9) of the Act to adopt rules fixing reasonable rates of commission and other charges (429A; 435A-436A); (2) the restriction upon the use of interim service charge revenues was neither taken with an anti-competitive purpose (436A), nor designed to achieve conformity in wages or reduce competition, and did not in practice have that effect (434A); (3) the prohibition on sharing was designed solely as a means to safeguard the financial responsibility of member firms, as required by Section 19(b)(1) of the Exchange Act, and to provide immediate assistance to the brokerage industry as a whole which was then in the throes of a financial crisis (435A; 413A); and, (4) competition in terms of compensation for the services of registered representatives remained "intense" during the period the service charge was effective (412A; 417A; 433A) and member firm compensation practices continued to vary widely.* (417A; 433A)

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* While plaintiffs suggest (Pl.Br. p. 19) that this Court has a somewhat greater latitude to reconsider a documentary record than it might otherwise have in an instance where credibility is a factor in a District Court's findings, obviously plaintiffs cannot retry their case in this appellate forum or ask this Court to substitute its judgment for that of the Court below. As the Supreme Court has admonished:

> ". . . appellate courts must constantly [bear] in mind that their function is not to decide factual issues *de novo*" Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 123 (1969).

The District Court summarized its finding as follows:

> ". . . the service charge was approved after actual Commission scrutiny. The Commission judged it necessary for the protection of investors that immediate interim measures be taken to supply additional revenue to rapidly failing brokerage firms. In this sense, the service charge itself was necessary to make the securities laws work. Moreover, to insure that the additional charge to investors was in fact used to further the end for which it was enacted, the Commission formally required that the revenue so generated be retained by the firms effecting the transactions and be used prudently to achieve financial stability. While the Commission did not formally require that the service charge be excluded from the formulae for compensating registered representatives, and indeed, when the latter objected to the exclusion informed them that this was a matter in which it would not intervene, it is entirely consistent with the purpose for which the charge was levied, that it be so excluded. The revenue was thereby retained at the level judged most crucial, and individual firms remained free to decide for themselves whether to increase the salaries of their employees. In fact, the evidence at trial showed that the revenue generated by the service charge was insufficient to keep the firms from operating at a loss, but at best, merely stemmed the continued erosion of capital and relieved the most acute financial pressure on some of the firms. Thus, the limitations the Exchange imposed themselves furthered the purposes of the securities laws." (435A-436A)

Accordingly, on the weight of the evidence and in the absence of any proof to the contrary, the District Court properly concluded (436A-437A) that the challenged rules had no effect on competition and were both reasonable in light of the financially distressed condition of Exchange

member firms and justified under the Exchange Act because in aid of investor protection.

II.

Moreover, the Self-Regulatory Conduct Challenged was Exempt from the Antitrust Laws

A. *Silver* and *Gordon* Compel a Finding of Exemption Because the Self-Regulatory Conduct Challenged was Subject to the Control of, and Actually Reviewed by, the SEC.

Since this Court's decision in *Gordon,* it is the law of this Circuit that Exchange rules adopted pursuant to Section 19(b) of the Exchange Act and subject to the SEC's statutory oversight jurisdiction are exempt from antitrust attack.

The *Gordon* decision—which mandates an exemption on the facts of this case—was soundly grounded upon the principles, laid down by the Supreme Court in *Silver,* of *pro tanto* repeal of the antitrust laws by the Exchange Act.

In *Silver,* the Supreme Court recognized that the Exchange Act established a unique system of self-regulation which placed upon the nation's registered securities exchanges the initial duty to promulgate rules governing their own affairs and committed to the SEC as guardian of the public interest a power of oversight and revision of those rules. Likewise, the Supreme Court pointed out that although the Exchange Act contains no express exemption from the antitrust laws and its regulatory scheme is not sufficiently pervasive to create total exemption as to all exchange activities, nevertheless repeal of the antitrust laws is to be regarded as implied where a particular instance of exchange self-regulation falls within the scope and purposes of the Exchange Act and is subject to the SEC's power of review and revision. (373 U.S. at 357, 360-61)

It was likewise recognized in *Silver* that to subject self-regulatory activities of the Exchange to antitrust review in areas where the SEC has supervisory jurisdiction could involve problems of "conflict or coextensiveness of coverage with the [SEC's] regulatory power". (373 U.S. at 358) It was the absence of SEC power to review the specific action of the Exchange involved in the *Silver* case (withdrawal of certain non-member private wire connections) which led the Supreme Court to conclude that in the special circumstances there presented application of the antitrust laws was not incompatible with the provisions of the Exchange Act. At the same time the Court emphasized that:

> "Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented." (373 U.S. at 360)

The issue reserved in *Silver* and presented by this case was squarely met by this Court in *Gordon,* where an antitrust attack was directed at the Exchange's fixed minimum commission rules—adopted under the same statutory authority, Section 19(b)(9), as the interim service charge. The District Court, holding in abeyance the plaintiff's motion for a class action determination, granted defendants' motion for summary judgment and dismissed the complaint.

In affirming the District Court's decision in *Gordon,* this Court recognized that the assertion of antitrust jurisdiction over self-regulation subject to SEC review would produce the very "conflict or coextensiveness of coverage with the [SEC's] regulatory powers" sought to be eliminated by *Silver* and, likewise, "render ineffective the supervised self-regulatory scheme designed to accomplish the aims of the [Exchange] Act." (498 F.2d at 1306)

Accordingly, this Court determined that an antitrust attack on self-regulation subject to SEC review jurisdiction is *Silver's* "different case" because, in the words of the

Supreme Court, "[r]epeal is . . . necessary to make the Securities Exchange Act work" (373 U.S. at 357) and to avoid the frustration of that Act's aims which "would be the inevitable consequence of duplicative or inconsistent standards announced contemporaneously by courts and [the SEC]". (498 F.2d at 1306)*

Plaintiffs dispute none of this; in fact, they concede that, under *Silver* and *Gordon* (Pl. Br. pp. 39-40), the SEC's jurisdiction and an exchange's antitrust exemption are coterminous. Similarly, they admit that there is no antitrust remedy for SEC-supervised self-regulation and that the only proper remedy is by way of review of SEC orders in a Circuit Court under Section 25 of the Exchange Act (15 U. S. C. § 78y) or *de novo* review of SEC action or inaction in a District Court under the Administrative Procedure Act (5 U. S. C. §§ 702, 704).

The District Court found, as a fact, that the service charge and the rules under which it was adopted and implemented were "matters over which the [SEC] possessed and exercised direct regulatory control". (423A) Likewise, the record demonstrates that the SEC approved the interim service charge, while fully aware that under the Exchange's Constitution and Rules the emergency revenues generated would not be directly shared with registered representatives but would rather in the first instance be retained by member firms to improve their financial condition.

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* When the Seventh Circuit was confronted with the same conflict between the antitrust laws and the Exchange Act, it also found an exemption. Kaplan v. Lehman Bros., 250 F.Supp. 562 (N.D. Ill. 1966), *aff'd,* 371 F.2d 409 (7th Cir.), *cert. denied,* 389 U. S. 954 (1967). *Cf.*, Thill v. New York Stock Exchange, *supra,* and Fredrickson v. Merrill Lynch, Pierce, Fenner & Smith, Inc. 5 CCH Trade Reg. Rep. 1974-2 Trade Cas. ¶ 75,227 (N.D.Ill., Sept. 9, 1974). In the latter case, while the District Court—relying on the authority of *Thill*—denied defendants' motion to dismiss the complaint on the grounds of an exchange's antitrust exemption, in view of *Kaplan* and *Gordon,* it certified the issue to the Seventh Circuit under 28 U.S.C. § 1292(b). On October 25, 1974, the Seventh Circuit, in turn, granted leave to the defendants to file an interlocutory appeal.

At trial, it was shown that the SEC refused to intervene on behalf of registered representatives, despite their repeated attempts to persuade the SEC to request or order a rule change. Nonetheless, the SEC did not close the door on the possibility that a proper showing by registered representatives might convince it to exercise the Commission's conceded jurisdiction:

> ". . . the Commission stands ready to receive evidence from interested persons [*e.g.*, registered representatives] which demonstrates, with particularity, that additional regulatory action on our part is necessary or appropriate for the protection of investors." (322A)

No registered representative accepted the SEC's invitation to make a case for SEC action. By the same token, plaintiffs, who bad ample opportunity to pursue their proper remedies—administrative review of the Exchange's action and judicial review of the SEC's alleged inaction—chose instead to file an antitrust class action for treble damages and attorneys' fees.

Plaintiffs' failure to seek a proper remedy for their claimed grievance is no grounds for the assertion of an antitrust claim. It is beyond question that on the record below the challenged conduct is exempt from antitrust attack under *Silver* and *Gordon.*

B. Plaintiffs Cannot Avoid the Authority of *Silver* and *Gordon* by Misplaced Reliance on *Ware.*

Plaintiffs on this appeal find themselves faced with a dilemma: they concede the interim service charge, under the authority of *Silver* and *Gordon,* is antitrust exempt because adopted and implemented as a valid exercise of Exchange self-regulation, fully subjected to SEC review (see 429A); but at the same time plaintiffs challenge as an antitrust violation the prohibition against sharing service charge revenue, which is contained in, and is part and parcel of,

the same rules and provisions of the Exchange Constitution and Rules which authorized the service charge.

Plaintiffs try to avoid their dilemma by arguing (Pl. Br. pp. 31-34) that *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117 (1973)—which was not a federal antitrust case and involved no question of exemption—supports the proposition that they may separate the antitrust validity of the SEC-approved rules involved here from the alleged, but unproved, incidental effect those rules might have had on registered representatives.

Plaintiffs' argument appears to be that (1) *Ware* permitted the application of state law to foreclose arbitration (under Exchange rules adopted pursuant to federally delegated power—though not under Section 19(b)) of a registered representative's claim against a member firm; (2) this means that the matter of employer-employee relationships, and particularly employee compensation, was not within the SEC's power under Section 19(b) of the Exchange Act because unrelated to the protection of investors; and, (3) the Exchange restriction on sharing service charge revenues with registered representatives was likewise without the SEC's authority and therefore not exempt from the antitrust laws. The argument is a complete non sequitur.

In *Ware,* the Court decided the question of preemption by looking to §§ 6(b) and 19(b) of the Exchange Act, 15 U.S.C. §§ 78f(b) and 78s(b). The Court concluded that the Exchange rule providing for arbitration was simply not within the scope of these statutory provisions and therefore preemption of California law and its strong public policy was not required.

On the other hand, this is a "different case"; here the rules challenged are directly within Exchange self-regulatory authority to set reasonable member firm charges (Section 19(b)(9)) and to safeguard the financial responsibility of member firms (Section 19(b)(1)); each of these

self-regulatory concerns is intimately related to the protection of investors. The SEC treated the interim service charge rule as one designed for investor protection and exercised its review authority accordingly. Thus, the District Court expressly found the resulting prohibition on sharing of the service charge revenues with registered representatives—part and parcel of the rule—necessary to the protection of investors.

It is no answer to the plain existence of the Exchange's self-regulatory authority over the matters in question to charge that its exercise in this case—approved by the SEC—had an effect on registered representatives. The Exchange's authority to regulate is not limited to activities which affect only its members. The Supreme Court in *Silver* noted the inevitable effect of Exchange self-regulation upon non-members:

> "It is no accident that the Exchange's Constitution and rules are permeated with instances of regulation of members' relationships with nonmembers including nonmember broker-dealers . . .
>
> * * *
>
> "In light of the important role of exchanges in our economy and the 1934 Act's design of giving the exchanges a major part in curbing abuses by obligating them to regulate themselves, it appears conclusively—contrary to the District Court's conclusion—that the rules applied in the present case are germane to performance of the duty, implied by § 6(b) and § 6(d), to have rules governing members' transactions and relationships with nonmembers. The Exchange's enforcement of such rules inevitably affects the nonmembers involved, often (as here) far more seriously than it affects the members in question. The sweeping of the nonmembers into the currents of the Exchange's pro-

> cess of self-regulation is therefore unavoidable; the case cannot be disposed of by holding as the district judge did that the substantive act of regulation engaged in here was outside the boundaries of the public policy established by the Securities Exchange Act of 1934." (373 U. S. at 354, 356-357)

For this purpose, no meaningful distinction can be drawn between a non-member who is a broker and a non-member who is a registered representative. By the same token, no proper distinction can be drawn between antitrust-exempt Exchange rules and their incidental effects.

In sum, then, while the District Court properly dismissed plaintiffs' action under the rule of reason, its dismissal could and should have been on the ground of antitrust exemption.

Conclusion

For the foregoing reasons, this Court should, under the authority of its decision in *Gordon,* as well as *Silver* and its progeny, affirm the decision below on the twin grounds that the self-regulatory conduct attacked below was (a) exempt from the antitrust laws and (b) both reasonable under the antitrust laws and justified under the Exchange Act.

Respectfully submitted,

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October 30, 1974